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Supreme Court of the United States

OCTOBER TERM, 1967

No. 324

NORFOLK AND WESTERN RAILWAY COMPANY and WABASH RAILROAD COMPANY, *Appellants,*

v.

MISSOURI STATE TAX COMMISSION; HUNTER PHILLIPS; HOWARD L. LOVE; J. RALPH HUTCHINSON, Members of the Missouri State Tax Commission, and J. R. TOWSON, Secretary of the Missouri State Tax Commission, *Appellees.*

ON APPEAL FROM THE SUPREME COURT OF MISSOURI

BRIEF FOR APPELLANTS IN OPPOSITION TO MOTION TO DISMISS OR AFFIRM

I

In asking this Court to dismiss the appeal or to affirm the judgment below without plenary consideration, appellees argue that the questions presented are insubstantial because their resolution would affect only the valuation of Norfolk & Western properties in

Missouri. We submit that this kind of argument is more properly addressed to a petition for certiorari than to a case in which the Court's mandatory appellate jurisdiction is invoked.[1] In any event, the fact is that the resolution of this case will affect not only Norfolk & Western but every other railroad subjected to the risk of excessive and multiple taxation of its property by application of the Missouri formula or any formula like it.

The basic constitutional question posed is intrinsically important. We do not understand the appellees' suggestion of a constitutional distinction between "violation of established principle" and "misapplication of such principles." (Motion at 14). In its application, misapplication if you will, of the mileage formula Missouri violated the established principles that the formula may not be used for "taxing property outside the State under a pretense," *Fargo* v. *Hart*, 193 U.S. 490, 500 (1904), and that

> "no property of . . . an interstate road situated elsewhere can be taken into account unless it can be seen in some plain and fairly intelligible way that it adds to the value of the road and the rights exercised in the State." *Wallace* v. *Hines*, 253 U.S. 66, 69 (1920).

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[1] Apart from their contentions concerning the substantiality of the questions presented, appellees do not contend the case is not properly here on appeal. They do remark that "appellants do not challenge the constitutionality of the assessing Missouri statute per se . . . ." (Motion at 2; *see id.* at 7). The challenge here, as it was below (*see* Jur. St. at 10-11; R. 138-39, 154-57), is to the constitutionality of the statute as applied to appellants. There is no doubt that when such a challenge is rejected by the highest court of a state an appeal lies to this Court. *E.g.*, Dahnke-Walker Milling Co. v. Bondurant, 257 U.S. 282 (1921).

This Court has repeatedly warned of the potential for abuse inherent in the mileage formula. The caution with which the Court has approached the mileage formula has always turned on the risk that a state availing itself of the formula might reach more property than was actually within the taxing jurisdiction of the state or more income than was fairly attributable to business carried on in the state. *See Nashville, C. & St. L. Ry.* v. *Browning,* 310 U.S. 362, 366 (1940); *Rowley* v. *Chicago & N.W. Ry.,* 293 U.S. 102, 110 (1934); *Southern Ry.* v. *Kentucky,* 274 U.S. 76, 82-84 (1927); *Wallace* v. *Hines, supra* at 69; *Union Tank Line Co.* v. *Wright,* 249 U.S. 275, 282-83 (1919); *Fargo* v. *Hart, supra* at 500; *Pittsburgh, C.C. & St. L. Ry.* v. *Backus,* 154 U.S. 421, 434-36 (1894).

Appellants submit that the risk materialized here when the State Tax Commission, applying the Missouri statutory mileage formula mechanically, ascribed to Missouri 8.2824 per cent of the value of the Norfolk & Western's rolling stock in the face of uncontradicted and unquestionable evidence that the units of rolling stock in Missouri on January 1, 1965, actually amounted to only 2.71 per cent of the total units, and 3.16 of the money value, of the entire Norfolk & Western fleet. Missouri thus claimed taxing power over nearly three times the amount of property actually within her jurisdiction.

In pursuit of the "continuing concern for fair apportionment which this Court has displayed over the years in scrutinizing state taxing statutes," *General Motors Corp.* v. *District of Columbia,* 380 U.S. 553, 561-62 (1965), the Court has frequently treated questions such as the question posed by appellants on these facts as worthy of its full-dress attention.

II

Appellees make no serious effort to counter the proposition that Missouri took into its property tax account a grossly disproportionate share of the Norfolk & Western's rolling stock. Instead, they interject an issue that confuses matters. They claim that (1) the Wabash line underwent an "enhancement in value" as a result of being leased to the Norfolk & Western; and (2) the Tax Commission used the mileage formula to measure this "enhancement in value."

This argument utterly misconceives the way in which the mileage formula works and how railroad rolling stock is valued. Nowhere in either its findings of fact or conclusions of law (Jur. St. at 5a-11a) does the Commission indicate that it considered the possibility of an enhancement in the value of Wabash rolling stock. There has been no finding by the Commission that the rolling stock of the Wabash underwent any enhancement in value whatsoever. The issue was first injected on appeal, as a defense of the Commission's use of the mileage formula. The Missouri Supreme Court, quite without reference to the record, decided that the rolling stock must have become more valuable because the parties to the transaction probably thought the combined system would be more valuable. (Jur. St. at 18a). This is mere speculation as to the business motives of the parties. It is not a finding of fact such as is entitled to deference on review by this Court. It is certainly no basis for application of the mileage formula to measure enhancement in value.

The Tax Commission plainly did not think of itself as using the mileage formula to measure enhanced

value. It did not advance the proposition that a Wabash boxcar worth $2,000 in 1964 was worth $6,000 in 1965 even though it was hauling the same items over the same tracks in the two years. Any such proposition was foreign to its method of valuation, which was, in the case of rolling stock, mechanically to apply the mileage formula to total valuation figures supplied by the Norfolk & Western. It is notable that the Commission's valuation of the Wabash's fixed property, which was valued physically without use of the formula, was about the same before and after the lease. (Jur. St. at 19). Unlike the rolling stock—and altogether inconsistently with the explanation offered by the court below, and now by appellees, for the increased valuation of the rolling stock—the tracks and terminals are not claimed to have been enhanced in value by the lease.

The fact is of course that no more than fixed property does rolling stock magically increase in value when it comes under the dominion of a larger railroad. Revenue from boxcars is determined by how much freight they haul; if operations do not change, their revenue-producing capacity, and therefore their value, remains constant. The undisputed evidence shows that the operations over the Wabash tracks in Missouri were substantially the same in 1965 as in 1964 and previous years. Certainly, then, there could have been no enhancement in the value of the cars that were in Missouri.

III

In the end, however, it is not so much valuation as allocation with which we are concerned in this case. And there is no support in logic, or in judicial au-

thority, for the proposition that a state can allocate to itself for tax purposes 8 per cent of an enterprise's property, when only 3 per cent of that property is within the state, on the ground that in doing so it merely recognizes the enhanced value of the property within the state caused by its being part of the larger interstate whole.

Yet that is the justification offered by the appellees for Missouri's action here. Appellants have asserted that the Tax Commission mechanically followed the mileage formula. Not so, say the appellees. They explain (Motion at 11-12):

The Commission used the formula alone to make an initial assessment but then received appellants' evidence concerning the units and value of rolling stock actually in Missouri, the density of Missouri traffic compared to system traffic and the like. (We leave to one side the fact that much of this evidence was objected to by counsel for the Commission and its worth discounted in advance by the Chairman of the Commission, as indicated by his comments from the bench, because of their belief that it was irrelevant to the Commission's statutory duty to apply the mileage formula. [*E.g.*, R. 43-47, 51-52, 80, 100-01]). The evidence was found by the Commission to be insufficient to justify setting aside the assessment.

But even though this uncontradicted evidence was the "clear and cogent evidence" that this Court has demanded in this kind of case, *Norfolk & Western Ry.* v. *North Carolina ex rel. Maxwell,* 297 U.S. 682, 688 (1936), and showed that the Missouri mileage proportion did not yield a fair measure of the Norfolk & Western rolling stock in Missouri, the Commission stated nothing more than its bare conclusion that the

evidence was insufficient. The Commission's process of decision, it seems to us, is therefore properly described as mechanically applying the mileage formula, but, regardless of the characterization, it is clear that the formula was applied without taking account of any other factors and without explanation of why those factors were ignored.

Appellees and the Missouri Supreme Court have attempted to supply the Commission with a justification for its rejection of appellants' case. They state, in appellees' words, that appellants' "evidence excludes any enhanced value resulting from the lease by N & W." (Motion at 11; *see* Jur. St. at 17a-18a). That explanation will not do because in fact, when taken with the Commission's valuation of Norfolk & Western rolling stock as a whole, appellants' evidence established that there was no enhancement of value but that, rather, Missouri was ascribing to itself an impermissibly large share of that rolling stock.

The inadequacy of the justification offered is illustrated by appellees' discussion of the discrepancy between the assessment of rolling stock in the hands of the Wabash in one year and much the same rolling stock in the hands of Norfolk & Western the following year. (Motion at 10). The increase was from $10 million to $19 million. Evidence of this increase by itself did not negate the possibility that it was brought about by factors that would legitimately have entitled Missouri to assess at the higher figure. These factors might have been either (1) an augmentation of the taxable presence in Missouri (through the bringing of more cars and locomotives or more expensive cars and locomotives into the state because of integration of the Wabash and Norfolk & Western systems); or (2)

a valuation of the entirety of the Norfolk & Western's rolling stock such that the percentage that Missouri could fairly attribute to itself was of greater value than the percentage of the Wabash fleet taxable by Missouri. This latter would have been a kind of enhancement of value by reason of the lease. Within rational limits recognition of it would be in pursuit of the rule correctly stated by appellees that a state may tax an interstate railroad by valuing its entire system and then taking a percentage of that valuation "according to some *fair* and *reasonable* method of apportionment." (Motion at 8-9). (Emphasis added).

The other undisputed evidence submitted by appellants did negate the possibility either of an augmented taxable presence or a legitimately enhanced valuation. The evidence showed that there was neither an increase in the number of locomotives and cars used in the state nor an increase in value that could fairly be put upon the locomotives and cars in the state either as individual units or as parts of the Norfolk & Western fleet. The valuation of the entire fleet by the Tax Commission on the basis of data supplied by the Norfolk & Western is not questioned on either side; appellants' evidence as to the units of rolling stock in Missouri at representative times showed that by no "fair and reasonable method of apportionment" could Missouri take a share of the total value that even approached the figure at which the 1965 assessment was made.

On this view, appellants' showing of the increase in assessment was relevant to their case, even though a mere increase in an assessment does not prove the higher assessment wrong—an obvious point that appellees belabor. *See Pittsburgh, C.C. & St. L. Ry.* v. *Backus,* 154 U.S. 421 (1894).

The heart of appellants' case, however, lay in their showing that the ratio of Missouri mileage to total mileage bore no reasonable relationship to the ratio of locomotives and cars in Missouri, by units and by value, to the total number of units and value of the Norfolk & Western's rolling stock. Such a showing poses the classical case for invalidation of a mileage formula in its application. *Wallace* v. *Hines,* 253 U.S. 66 (1920); *Union Tank Line Co.* v. *Wright,* 249 U.S. 275 (1919); *Fargo* v. *Hart,* 193 U.S. 490 (1904).[2]

IV

The nearly $12 million that separates the depreciated, equalized value of rolling stock in Missouri from the Commission's assessment represents the value of property elsewhere in the Norfolk & Western system. This property is subject to taxation in the states where it is habitually used; Missouri's attempt to tax it exposes Norfolk & Western to the risk of multiple taxation in any states that employ fair apportionment formulas.

As has been pointed out (Jur. St. at 21-22), this Court has recently ruled that a state of domicile may constitutionally tax the whole value of a carrier's fleet, other than units shown to be habitually present in other states. *See Central R.R.* v. *Pennsylvania,* 370 U.S. 607, 613-14 (1962). The preferred method of computa-

[2] Appellees attempt to demonstrate that the mileage formula has not been applied unconstitutionally by minimizing the relevant financial data. They claim that since appellants challenge only 37.7% of the total assessment, the error cannot be considered "grossly excessive." (Motion at 12). The claim that an error of $12 million is not "grossly excessive" refutes itself. Moreover, the assessment of fixed properties has never been at issue here. With the elimination of fixed properties, the erroneous assessment is nearly three times a proper assessment of rolling stock. In no endeavor is such an error considered less than gross.

tion, of course, is the daily average number of cars in other states. *See* 370 U.S. at 613-14. If the domiciliary state is not required to adjust its formula for the possibility that some states such as Missouri will already have taxed more than their fair share of the stock, and Missouri and other states are allowed to tax according to the demonstrably arbitrary mileage formula, a carrier can be compelled to pay taxes on more than the total value of its rolling stock.

Appellees suggest that *Central R. R.* v. *Pennsylvania* would require a domiciliary state to refrain from taxing rolling stock that had been reached by the taxing statutes of other states—whatever the validity of the formula embodied in those statutes. That a domiciliary state would be required to defer its unquestioned right to tax, in the interest of avoiding clashes with the possibly unconstitutionally arrogated powers of another jurisdiction, seems most doubtful.

There is no merit whatever to appellees' final suggestion, which is that Missouri's statute ought not to be invalidated in its application and Missouri should be allowed to tax three times the value of the rolling stock actually in the state because in some states where traffic is denser than in Missouri use of the mileage formula might result in taxing less than those states' full share of Norfolk & Western's rolling stock. (Motion at 15). If every state used an inflexible mileage formula, there might be some point to the suggestion—although the justice of the situation would be at best a rough kind of justice. But not every state does use a mileage formula. West Virginia, for example, where much of the Norfolk & Western's coal traffic and equipment are centered, allocates value for property tax purposes on a formula that uses car and locomo-

tive miles, ton and passenger miles. These factors take full account of traffic density. *See* W. Va. Code Ann. ch.11, art. 6, §§ 1-2.[3] Were Missouri so situated that the mileage formula would yield to it less than a fair share of railroad property for taxation, nothing in the Constitution would prevent it from adopting some other, more flexible formula.

CONCLUSION

For the reasons stated here and in our Jurisdictional Statement, probable jurisdiction should be noted and the case heard on the merits.

Respectfully submitted,

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[3] The cited statute calls for certain information on property tax returns by railroads. The actual basis for assessment is composed of a combination of factors, spelled out by administrators of the taxing system in letters to railroads.